



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

1-10-03

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CONEX-166738-02  
CC:ITA:5

[REDACTED]

Dear [REDACTED]:

I apologize for the delay in responding to your inquiry dated November 4, 2002, on behalf of your constituent, [REDACTED]. [REDACTED] sold a house in 2001 that she owned and used as her principal residence for less than two years because after her divorce she could not afford to pay the housing costs. [REDACTED] understands she is not eligible to exclude the gain from the sale of the home under the general rules because she has not owned and used the house as her principal residence for at least two years. However, she asks whether the exception for unforeseen circumstances is available to her.

For sales or exchanges occurring after May 6, 1997, a taxpayer can exclude up to \$250,000 (\$500,000 for certain joint returns) of gain on the sale or exchange of property. To be eligible for the exclusion, the taxpayer must have owned and used the property as his/her principal residence for at least two years during the five years before the sale or exchange. The full exclusion is available only once every two years.

A taxpayer, who does not meet these general rules, can claim a reduced exclusion if his/her home is sold or exchanged due to a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances. Temporary regulations recently published in December 2002 provide that a taxpayer's primary reason for the sale or exchange is considered unforeseen circumstances if one of the safe harbor events occurs during the taxpayer's ownership and use of the property. The safe harbor events include divorce or legal separation under a decree of divorce or separate maintenance.

Therefore, [REDACTED] may be entitled to claim a reduced exclusion. The Reduced Maximum Exclusion Worksheet of Pub. 523 helps the taxpayer calculate the reduced exclusion. The reduced exclusion equals the statutory dollar limit of \$250,000 (\$500,000 for certain joint filers) multiplied by a fraction. As determined using the

Reduced Exclusion Worksheet, the numerator of this fraction equals the shorter of (1) the number of days that the taxpayer used the property as the taxpayer's principal residence during the 5-year period ending on the date of the sale, (2) the number of days that the taxpayer owned the property during the 5-year period ending on the date of the sale, or (3) the period of time between the date of a prior sale of another property for which the taxpayer excluded gain under section 121 and the date of the current sale. The denominator of this fraction is two years. This fraction may be expressed in years, months, or days.

The following example illustrates how to calculate the reduced exclusion. Assume that an unmarried taxpayer sells a home that the taxpayer has owned and occupied for exactly one year. Also, assume that: (1) the taxpayer has not used the section 121 exclusion during the past two years, (2) the sale was by reason of unforeseen circumstances, and (3) the taxpayer has not taken depreciation deductions with respect to the home after May 6, 1997. Under these facts, the reduced exclusion amount would equal \$125,000 ( $\$250,000 \times \frac{1}{2}$ ). The taxpayer would generally be entitled to exclude gain on the sale up to the reduced exclusion amount of \$125,000.

I hope this information has been helpful. More information on the section 121 exclusion, Publication 523, [Selling Your Home](http://www.irs.gov/pub/irs-pdf/p523.pdf) may be obtained at [www.irs.gov/pub/irs-pdf/p523.pdf](http://www.irs.gov/pub/irs-pdf/p523.pdf). If you have additional questions, please contact [REDACTED], [REDACTED] at [REDACTED]

Sincerely,

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William A. Jackson  
Chief, Branch 5  
(Income Tax and Accounting)